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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1955

NO. ——

GOLDSTEIN BROTHERS, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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The transaction involved constituted a non-taxable reorganization under the Internal Revenue Code and entitled the Appellant to use as a basis for its Excess Profits Tax Credit, the basis of the predecessor corporation	6

SUMMARY OF ARGUMENT

1. Under the Internal Revenue Code when a corporation files a petition in bankruptcy and its stockholders subscribe to the stock of a new corporation using the moneys paid in for the purchase of the bankrupt's assets and satisfying with said moneys the claims of the bankrupt's creditors, under such circumstances the new corporation has the assets of the old corporation and the same basis can be used for Excess Profits Tax invested capital credit ---------- 7-19

2. If the stockholders of the bankrupt corporation contributed to the capital of the bankrupt corporation and the contribution was used to pay off the bankrupt's creditors there would be no question that the cost basis of the corporate properties remained the same ---------- 7-19

3. If I.R.C. 112(b)10 is to be of any help in a reorganization through bankruptcy proceedings it can only be used as was done in the instant case. ---------- 7-19

4. Where the same persons who held the stock of the bankrupt corporation put up the money with which to

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satisfy the creditors of the bankrupt and took the stock of the new corporation thus transferring the assets from the bankrupt corporation to the new corporation through a sale approved by the Bankruptcy Court, this constitutes a reorganization of a corporation in a bankruptcy proceeding where no gain or loss is recognized 7-19

5. The instant action is on all fours with this Court's holding in *Rex Mfg. Co.* v. *C. I. R.*, 102 Fed. 2d 325, so that this Court cannot affirm the Tax Court without reversing itself. 16

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner, Goldstein Brothers, Inc., prays that a Writ of Certiorari issue to review the decision and decree of the United States Court of Appeals for the Seventh Circuit entered respectively on April 11, 1956 and modified May 18, 1956, affirming the decision of the Tax Court of the United States.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit is reported at *232 Fed. Reporter 2nd, P. 566.* The decision of the Tax Court of the United States is reported at *23 T.C. 1047.*

JURISDICTION

The decision of the Court of Appeals was entered on April 11, 1956, and was modified May 18, 1956. The jurisdiction

of this Court is invoked under 28 *U.S.C. 1254(1) and Rule 19* of this Court.

QUESTIONS PRESENTED

The respondent asserted a deficiency in excess profits tax and an overassessment in income tax for the years 1943, 1944 and 1945 together with a declared value excess profits over-assessment for the year 1943. This resulted in a total net deficiency of Twenty-Four Thousand, Forty-Seven and 14/100 ($24,047.14) Dollars. Said net deficiency is made up as follows:

Year	ICX Profits Deficiency	Income Tax O-A	DV Excess Profits—OA
1943	$17,573.04	$ 9,275.38	$49.59
1944	15,008.08	8,551.86	
1945	22,562.50	13,219.65	

Total net deficiency — $24,047.14

We call the Court's attention to the decision of the Tax Court (R. 35) which disregards the above figures so far as the over-assessment of income tax is concerned. While the taxpayer sought a redetermination of the assessment as shown by the deficiency letter — the Court ordered deficiencies of $55,000.00 and disregarded the credit of $31,000.00 which had resulted in a claimed net deficiency of $24,000.00.

This was corrected by the opinion of the Court of Appeals, but on Respondent's statement that an administrative credit would issue, it modified its opinion by a deletion of that correction.

STATUTE INVOLVED

The statute involved is Section 112 (b) (10) of the Internal Revenue Code of 1939, which provides that no gain or loss

shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended) is transferred, in a taxable year of such corporation beginning after December 31, 1933, in pursuance of an order of the court having jurisdiction of such corporation— (A) in a receivership, foreclosure, or similar proceeding, or (B) in a proceeding under section 77B of Chapter X of the National Bankruptcy Act as amended, to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation.

STATEMENT OF FACTS

For a statement of facts we adopt the statement as set forth and found in the opinion of the Tax Court of the United States and which was adopted as a statement of facts by the Court of Appeals.

> "Goldstein Brothers, a partnership, operated a retail home furnishings business prior to May 1, 1923. On that date Goldstein Bros. Inc., herein referred to as the old corporation, was organized under the laws of Indiana. The stockholders were the members of the partnership and held the original stock in the same proportions as their interests in the partnership. The net assets of the partnership on that date amounted to $434,612.49. The closing balance sheet of the partnership was used as the opening balance sheet of the old corporation except that good will was set up on the books at a value of $280,000.00 and the outstanding issued capital stock amounted to $714,612.40. 1400 shares of stock of no par value were issued in exchange for the assets of the partnership. On April 14, 1932, 335 shares of preferred stock of $100 par value were issued.
>
> "On January 13, 1934, the old corporation filed a voluntary petition in bankruptcy.

"In February 1934 the petitioner was organized under the name of Washington and Delaware Mercantile Company, with an authorized capital of 335 shares of preferred stock of $100 par value and 500 shares of common stock of no par value. The paid-in capital amounted to $33,500. The common stock was issued on December 31, 1935, to the former stockholders of the old corporation in the same proportions as their holdings in that corporation. This transaction was recorded on the petitioner's books as a debit to good will and credit to capital stock in the amount of $20,500.

"On February 26, 1934, the assets of the old corporation were sold at public auction by the trustee in bankruptcy to the petitioner for $48,025, which sale was approved by the referee in bankruptcy.

"The final report of the trustee in bankruptcy shows as follows:

Receipts of Trustee	$60,112.62	
Expenses of receiver corporation	1,844.87	$58,267.75
Disbursements:		
1st Dividend	$16,895.98	
Taxes	2,616.73	
Wages	654.98	
Administrative expenses, legal fees, receiver fees, etc.	10,131.02	30,298.71
Balance for second and final dividend		$27,696.04
Total claims of General Creditors		$84,474.88

"In August of 1934 the petitioner's name was changed to Goldstein Bros. Inc. The authorized preferred stock was increased at that time and again in 1936.

"In its excess profits tax returns for 1943, 1944 and 1945 the petitioner computed its excess profits tax credit by the invested capital method and used as the basis of the assets acquired at the public auction the basis of those

assets in the hands of the old corporation. In the 1943 return the computation was based upon $434,612.49 paid in for 1400 shares of stock in the old corporation, plus $33,500 paid for 335 shares of preferred stock. In determining the deficiencies the respondent took as the basis the cost to the petitioner at the sale, reducing the basis accordingly and resulting in a small excess profits credit.

"The parties agree that the issue is whether there was a reorganization within the meaning of section 112 (b) (10), Internal Revenue Code of 1939, so as to entitle the petitioner to use the basis of the assets in the hands of the old corporation in computing its excess profits credit."

REASONS FOR GRANTING WRIT

The decision of the Court of Appeals affirming the holding of the Tax Court of the United States does violence to and is in direct conflict with each of the following propositions of law:

"The Exchange of Stock for Stock is Satisfied When the Stockholders of a Bankrupt Corporation Pay for the Shares of Stock of a New Corporation and the Money Is Used to Acquire the Assets of the Bankrupt Corporation."

Helvering v. *Alabama Asphaltic Limestone Company*, 315 U. S. 179.

Rex Manufacturing Company v. *Commissioner*, 102 F. 2d 325.

"Continuity of Interest" Is Established if the Stockholders of the Bankrupt Corporation are in Control, as Stockholders of the New Corporation.

Adamston Flat Glass Company v. *Commissioner*, 162 F. 2d 875.

Lewis v. *Commissioner*, 176 F. 2d 646.

Southwest Natural Gas Company v. *Commissioner*, 189 F. 2d 332. Certiorari denied 342 U.S. 860.

The Overall Result Where the Stockholders of Bankrupt Corporation Become Stockholders of New Corporation and Assets in Hands of Bankrupt Corporation Fall Into Hands of New Corporation Is to Be Considered Rather Than the Various Steps Taken to Bring About Results.

Helvering v. *Investors*, 316 U.S. 525.
Helvering v. *Alabama Asphaltic Limestone Company*, 315 U.S. 179.

ARGUMENT

The taxpayer's prime contention in this case is that the lower court committed error in not sustaining the 1934 transaction as a non-taxable exchange under the provisions of the Internal Revenue Code. The lower court construed the language in such strictness that it completely overlooked the purpose of this remedial legislation.

The chief point involved in this case is whether or not a corporation formed by the stockholders of the old corporation and acquiring all of the assets of the old corporation through a bankruptcy proceeding may avail itself of the invested capital in the old corporation and take it over into the new corporation and base its excess profits tax credit upon such invested capital?

Do the facts herein indicate a non-taxable reorganization?

Section 112(b) (10) of the Internal Revenue Code as amended by Section 121 of the Revenue Act of 1943 is set forth hereinafter.

> "*Gain or Loss Not Recognized on Reorganization of Corporations in Certain Receivership and Bankruptcy Proceedings.*—No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended) is transferred, in a taxable year of such corporation beginning after December 31, 1933, in pur-

suance of an order of the court having jurisdiction of such corporation—

"(A) in a receivership, foreclosure, or similar proceeding, or

"(B) in a proceeding under section 77B or Chapter X of the National Bankruptcy Act as amended, to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation."

The basis of the new corporation's assets acquired as a result of the bankruptcy proceedings is the same in the hands of the new corporation as it was in the hands of the old corporation under Section 113(a) (22) of the Internal Revenue Code as amended by Section 121 of the Revenue Act of 1943.

"*Property Acquired on Reorganization of Certain Corporations.* If the property was acquired by a corporation upon a transfer to which section 112(b) (10), or so much of section 112(d) or (e) as relates to section 112(b) (10), is applicable, then, notwithstanding the provisions of section 270 of the National Bankruptcy Act, as amended, the basis in the hands of the acquiring corporation shall be the same as it would be in the hands of the corporation whose property was so acquired, increased in the amount of gain recognized to the corporation whose property was so acquired under the law applicable to the year in which the acquisition occurred, and such basis shall not be adjusted under subsection (b) (3) by reason of a discharge of indebtedness pursuant to the plan of reorganization under which such transfer was made."

"121(e). Act of 1943 Effective Date—Provisions having the effect of the amendments made by subsection (a), subsection (c) (3), and subsection (d) (2), (3), (4), (5), and (6), shall be deemed to be included in the revenue laws respectively applicable to taxable years beginning after December 31, 1933, but shall not affect any tax liability for any taxable year beginning prior to January

1, 1943. Provisions having the effect of the amendments made by subsection (b), subsection (c) (1) and (2), and subsection (d) (1), shall be deemed to be included in the revenue laws respectively applicable to taxable years beginning After December 31, 1931."

The excess profits credit is established by reference to Section 718(a) and Section 716(a) of the Internal Revenue Code.

"Section 718(a) *Definition*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

"(1) *Money Paid In*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital.

"(2) *Property Paid In*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913. If the property was disposed of before March 1, 1913, its basis shall be considered to be its fair market value at the time paid in. If the unadjusted basis of the property is a substituted basis, such basis shall be adjusted, with respect to the period before the property was paid in, by an amount equal to the adjustments proper under section 113(1) for determining earnings and profits;

"(3) *Distributions in Stock*—Distributions in stock—

"(A) Made prior to such taxable year to the extent to which they are considered distributions of earnings and profits; and

"(B) Previously made during such taxable year to the extent to which they are considered distributions of earnings and profits other than earnings and profits of such taxable year;

"(4) *Earnings and Profits at Beginning of Year*—The accumulated earnings and profits as of the beginning of such taxable year; * * *"

"Section 760(a) *Definitions, Etc.*—For the purposes of this section—

"(1) *'Exchange', 'Transferor', and 'Transferee'*— The term 'exchange' means a transaction by which one corporation (hereinafter called 'transferee') received property of another corporation (hereinafter called 'transferor') and the basis of the property received, in the hands of the transferee, for the purposes of section 718(a) is determined by reference to the basis in the hands of the transferor.

"(2) *Determination of Basis of Property Received* — The basis, in the hands of the transferee, of the property of the transferor received by the transferee upon the exchange shall be determined in accordance with section 718(a)."

The most recent consideration by The Tax Court of the questions involved herein, is in the case of *Pebble Springs Distilling Company*, 23 TC, No. 29, affirmed 231 F. 2nd 288, wherein Judge Rice, writing the opinion of the Court, stated:

"During the course of a liquidation which commenced in 1948, petitioner sold all of its noninventory assets to a corporation wholly owned by its controlling stockholders. The new corporation had broad powers to carry on the same business as petitioner as well as to conduct a real estate and other businesses. It rented the property to various tenants and was still in existence at the time of the hearing. The price at which the noninventory assets were sold was $331,428.54 less than their depreciated book value. Petitioner claimed a net operating loss on its return for the fiscal year ended March 31, 1949, and carried such loss back to its two preceding taxable years. Carry-back of the loss eliminated all taxes for those years.

"Held, the purchase of petitioner's noninventory assets

> by a corporation wholly owned by petitioner's controlling stockholders was pursuant to a plan of reorganization within the meaning of section 112(g) (1) (D) of the 1939 Code; hence, no loss is allowed on such sale."

In the case of *Palm Springs Holding Corporation* v. *Commissioner of Internal Revenue*, 315 U. S. 185, wherein the old corporation involved in financial difficulties, had a foreclosure proceeding instituted and a new corporation purchased the property at foreclosure sale, the transaction was held to constitute "a reorganization" within the Revenue Acts of 1932, 1934, Sections 112(i) (1) (A), so that the new corporation was entitled to use the cost of the realty to the old corporation as a basis in computing depreciation deduction in determining income and excess profits tax liability, since the "continuity of interest" test was satisfied.

The fact that no gain or loss is recognized in such a transaction, is pointed out by this Court in the case of *Helvering* v. *Investors*, 316 U. S. 525. At page 534 the Court stated:

> "If a transaction meets the requirements of Section 112(b) (5) the basis of the property in the hands of the acquiring corporation is the same at it would be in the hands of the transferor."

We direct your attention to the case of *Helvering* v. *Alabama Asphaltic Limestone Company*, 315 U. S. 179. In this case, the taxpayer corporation acquired all the assets of the old corporation pursuant to a reorganization plan consummated with the aid of the bankruptcy court. In computing its depreciation for the year 1934, the new corporation treated its assets as having the same basis which they had in the hands of the old corporation. The Commissioner disagreed with this treatment and asserted a deficiency claiming that the basis of the new corporation was the price paid at the bankruptcy sale. The Board of Tax Appeals rejected the position of the Commissioner, the Circuit Court of Appeals affirmed, and the Supreme

Court, upon review, sustained the holding of the Circuit Court. In the opinion, Justice Douglas stated:

> "Insolvency reorganizations are within the family of financial readjustments embraced in those terms as used in this particular statute. Some contention, however, is made that this transaction did not meet the statutory standard because the properties acquired by the new corporation belonged at the time, to the committee and not to the old corporation. That is true. Yet, the separate steps were integrated parts of a single scheme. Transitory phases of an arrangement frequently are disregarded under these sections of the Revenue Acts, where they add nothing of substance to the completed affair. * * * Here they were no more than intermediate procedural devices utilized to enable the new corporation to acquire all the assets of the old one, pursuant to a single reorganization plan."

Illustrative of the thinking of the Supreme Court of the United States is the most recent case of *Brown Shoe Company* v. *Commissioner of Internal Revenue*, 339 U. S., 583, 94 Lawyers Edition 1081. Here a community group transferred assets to the corporate taxpayer as an inducement to locate or expand its factory in the particular community. The question involved was whether or not assets contributed to the corporation by this community group were to be considered as part of its invested capital in the computation of its excess profits tax credit. The Commissioner's contention was that this was capital not contributed by its stockholders or earned by the corporation, and should not be given consideration. The Court, however, held otherwise. *If capital contributed by this community group is to be considered in basing an excess profits tax credit, why should assets of the predecessor corporation not be given equal consideration?* It is evident from the decisions above cited, as well as the *Brown Shoe Company case*, that this Court has considered them in the same category and has announced that they are to be considered in order to establish the excess profits tax credit.

In the earlier case of *Rex Manufacturing Company* v. *CIR*, 102 F. 2d 325, the Court of Appeals stated:

> "The refinancing of corporation by means of a bankruptcy sale, the purchase of property by nominee and the conveyance thereof to a newly formed company having 4,500 shares, 3,500 of the shares being held by four stockholders of old company, constituted a 'reorganization' within statutory definition of term as used in provision covering determination of gain or loss from sale or exchange of property. Revenue Act 1928, § 112(1) (1) (A), 45 Stat. 816, 26 U. S. C. A. § 112 note."

We further direct the Court's attention to the holding in the case of *United States* v. *Warwick Hotel*, 158 F. 2d 961:

> "Evidence sustained finding that foreclosure proceedings taken under first mortgage constituted a reorganization of corporation under the Revenue Act, with result that taxpayer was entitled under the act to use as its adjusted basis for the depreciation of the properties the unrecovered original cost-basis of the properties in the hands of old corporation and that new corporation was entitled to deductions for depreciation for income tax purposes. Revenue Act 1932 §§ 112(i), 113(a) (7), 26 U. S. C. A. Int. Rev. Acts, pages 513, 516; Revenue Act 1938§ 113(a) (12), 26 U. S. C. A. Int. Rev. Acts, page 1051."

Continuity of Interest

Respondent seems to advance the theory that "continuity of interest" can only be established if the *creditors or bondholders of* the old company are in control of the new company after a reorganization. We respectfully submit that this theory is without logic or sense. If as a result of a reorganization, pursuant to a plan, whether in a bankruptcy or receivership or foreclosure case, a new corporation evolves and either the *shareholders* of the old corporation are in control of the new corporation, *or the bondholders* of the old corporation, or the

bondholders and the shareholders of the old corporation are in control of the new corporation, a "continuity of interest" is established.

In the case of *New Jersey Mortgage and Title Company* v. *Commissioner of Internal Revenue*, 3 T. C. 1277, the Court held that in a foreclosure proceeding in the Courts of New Jersey, where a plan was worked out for the reorganization of the corporation involving the forming of a new corporation, to which the assets of the old corporation were transferred, and the new corporation issued bonds to the old bondholders and stock to the old stockholders, the Court held that these transactions constituted a reorganization under Section 112(g) (1) (B), Revenue Act of 1934, as amended, the gain or loss resulting therefrom is not taxable under Section 112(b) (4) or Section 112(b) (4) or Section 112(b) or (3) of that Act, and petitioner's basis as to the property so acquired is the same as that of its predecessor.

In *Roosevelt Hotel Company*, 13 T. C. 399, the Court held that where the bondholders of a corporation that had defaulted on its bonds pursuant to a plan or reorganization, organized a new corporation that bought in the property at a foreclosure sale and the stock in the new corporation was issued to the bondholders in proportion to their holding, that the new corporation had acquired the property of the old corporation pursuant to a plan of reorganization and solely for voting stock within the meaning of Section 112(g), Internal Revenue Code, and is entitled to use predecessor's basis.

In the case of *Bedford* v. *Commissioner of Internal Revenue*, 150 Fed. 2d 341, the Court of Appeals of the Second Circuit held that the test in determining whether rights received pursuant to a reorganization constitute a "security" within statute providing that no gain or loss shall be recognized if securities in corporation, a party to reorganization, are exchanged solely for securities, is whether they give recipient a continuing in-

terest in the enterprise different from that of a general creditor, and the same test should be applied in determining whether what recipient of securities gave in exchange was also a security. 26 U. S. Code Annotated, Internal Revenue Code, Section 112(b) (3) (1) (1) Bankruptcy Act, Section 77 B, 11 U. S. C. A. Section 207. In this case the stockholders in the old corporation received stock in the new corporation.

In the case of *Adamston Flat Glass Company* v. *Commissioner of Internal Revenue*, 162 Fed. 2d 875, decided by the Fourth Circuit, the Court stated that continuity of proprietary interest between original owner and taxpayer which bought property from purchaser at foreclosure sale pursuant to plan, was sufficient to constitute transaction a reorganization within statute for purpose of basis of depreciation of certain assets. The Court stated that shareholders and creditors could not be combined for purpose of attaining the 50% interest required by statute permitting transferee of debtor's property in connection with the reorganization to use same basis for determining gain or loss as transferor would have used if immediately after transfer an interest or control of such property of 50% or more remains in the same persons or any of them. It is evident from a reading of this decision that continuity of proprietary interest can be established where either the shareholders or the creditors are in control of the corporation after the reorganization. In the case of *Lewis* v. *Commissioner of Internal Revenue*, 176 Fed. 2d 646, the Court pointed out that in determining whether a statutory reorganization took place for tax purposes, *the Court would not be controlled by whether in particular case it would be to the advantage of government or of taxpayer to make out that no statutory reorganization had been affected*. The Court stated that the essence of a statutory reorganization is a continuance of proprietary interest in a continuing enterprise in a modified corporate form, the transaction being deemed insufficiently closed economically to justify

a tax at the time, except insofar as the stockholder gets something in addition to stock or securities in the reorganized company. In that case the Court held that where a company having a department for the manufacture of synthetic resin also a department or business of chemical distribution sold these departments and a new corporation was formed to which most of the assets were transferred in exchange for stock of the new corporation, and the new corporation was to continue chemical manufacturing business, and the old corporation was dissolved, the Court stated that the transaction was a "reorganization" within meaning of Internal Revenue Code and gain resulting from transaction on dissolution of the old corporation would be reorganized in full since it was less than cash and securities distributed to stockholders.

We direct the Court's attention to the case of *Southwest Natural Gas Company* v. *Commissioner of Internal Revenue*, 189 Fed. 2d 332 (1951), certiorari denied in 342 U. S. 860. The Court stated that the test of continuity of interest must be met before a statutory merger of corporations may properly be held a reorganization within the terms of the statute regulating computation of net income for income tax purposes. The Court further stated that in determining whether there has been a reorganization within provisions of income tax law *each case must be controlled by its own peculiar facts*. The Court then holds that under income tax provisions relating to computation of net income upon reorganization of corporations, *requirement of continuity of interest is not fulfilled unless there is a showing that transferor corporation or its shareholders retains a substantial proprietary stake in the enterprise represented by a material interest in the affairs of the transferee corporation, and that such retained interest represents substantial part of the value of the property transferred*, 26 U. S. C. A. Section 112(q) (1) (A). It is thus evident that in the latest decision by the lower Court the continuity of interest is established when the share-

holders of the old corporation are in control as shareholders of the new corporation. This is directly contrary to respondent's contention in the instant case where he claims that continuity of interest can only be established through control by creditors.

The Tax Court cited as authority for its action, the prior decision of the lower court in *D. W. Klein Company* v. *Commissioner of Internal Revenue*, 123 Fed. 2d 871. In the *Klein* case, a holder of preferred stock bought the assets of the bankrupt corporation. This preferred stock holder formed a new corporation and transferred the assets to it in exchange for its common stock. In distinguishing this case from its previous decision in *Rex Manufacturing Company* v. *Commissioner*, 102 F. 2d 325, the Court of Appeals stated:

> "This Court has held that a reorganization, non-taxable under the provisions of Section 113, may be effected through the medium of a foreclosure sale or proceedings in bankruptcy.
>
> "Such was our conclusion in the cases, *Commissioner* v. *Kitselman*, 89 F. 2d 458 and *Rex Manufacturing Company* v. *Commissioner*, 102 F. 2d 325, upon both of which Petitioner relies. However, to say that a non-taxable reorganization may be so effected, is not to say that every reorganization brought about by means of such proceedings is non-taxable."

In the instant case, we contend that the found facts fit the holding in the Rex case, and that the holding in the Klein case is inapplicable.

We direct the Court's attention to the most recent holding of the Sixth Circuit in the case of *Seiberling Rubber Company* v. *Commissioner of Internal Revenue*, 169 F. 2d 595:

> " Where insolvent subsidiary which owed unsecured indebtedness to parent corporation in amount of $323,993 sold its assets in 1934 to a new corporation which assumed all indebtedness of subsidiary, and parent received all cap-

ital stock of new corporation and a note for $23,993 in settlement of the indebtedness, and parent then took up the outstanding preferred stock of subsidiary by exchanging therefor a part of the common stock received by it from new corporation, the transaction constituted as to parent an exchange in which no gain or loss was recognizable under the Revenue Act of 1932. Revenue Act of 1932, § 112(b) (3-5), (i) as amended, 26 U. S. C. A. Int. Rev. Acts, pp. 511, 513, 514."

In the case of *Bard-Parker Company* v. *CIR*, 218 F. 2d 52, the Court stated in its Syl. 1:

"Where liquidating directors of old corporation, pursuant to stockholders' resolution, transferred assets of old corporation to new corporation in exchange for stock in new corporation, intangible assets of old company acquired in exchange for stock in new corporation was a tax-free acquisition in connection with a reorganization, and basis of those assets was same as it would have been in hands of old company and that basis represented new corporation's equity invested capital for purpose of computing its excess profits tax credits. 26 U. S. C. A. §§ 112(a) (7), 113, 718 (a) (2); Revenue Act 1928, § 112, and (b) (4, 5), 26 U. S. C. A. Int. Rev. Acts, page 337; Revenue Act 1940, 26 U. S. C. A. Int. Rev. Acts, page 30; Stock Corporation Law N. Y. § 22."

In a well reasoned opinion by the United States District Court, *Minneapolis N. & S. Railway* v. *Kelm, Collector*, 117 F. Supp. 325, the Court stated that to have a reorganization entitling the new corporation to the old corporation's adjusted basis as cost of corporate assets for income and excess profits tax purposes, it is essential that a substantial ownership in reorganization enterprize be held by those in whom such interest resided prior to reorganization, 26 U. S. C. A. Section 113(a) (7).

The decision of the lower court in the instant case marks a departure from what has been announced by the Court as the doctrine of a "continuity of interest". The Court in this case, concluded that continuity of interest can only be established if the creditors of the old corporation are carried over to the new corporation. This would completely frustrate what ever benefits are offered by Section 112 of Internal Revenue Code in reference to bankruptcy proceeding. Generally a bankruptcy proceeding results in a satisfaction and elimination of the class of creditors. It is true that in railroad reorganizations, the creditors, bondholders and security holders are generally under a plan carried over to the reorganized or new corporation, but this is seldom the fact in the reorganization of commercial companies through bankruptcy proceedings. A good statement of this test is set forth in the Court's opinion in *Scofield* v. *San Antonio Transit Company*, 219 F. 2d 149, at page 153:

> "However, taking into consideration the underlying congressional purpose of postponing tax consequences when there has been a change in form only, the courts have implemented the statutory language by establishing the 'continuity of interest' test.[6] There have been many cases involving this problem, some of which also discussed '**continuity of interest**', each being decided on its own facts; but any attempt to summarize or discuss them all would unduly lengthen this opinion. As we understand the rationale of the cases, the courts do not purport to express any precise, iron-clad rule against which 'continuity of interest' can be measured in every case. Compositely,

[6] "See, for example *Pinellas Ice & Cold Storage Co.* v. *Commissioner*, 1933, 287 U. S. 462, 53 S. Ct. 257, 77 L. Ed. 428; *LeTulle* v. *Scofield*, 1940, 308 U. S. 415, 60 S. Ct. 313, 84 L. Ed. 353; *John Nelson Company* v. *Helvering Company*, 1935, 296 U. S., 374, 56 S. Ct. 273, 80 L. Ed. 281; *Helvering* v. *Minnesota Tea Company*, 1935, 296 U. S., 378, 56 S. Ct. 269, 80 L. Ed. 284, affirming 8 Cir., 76 F. 2d 797 and *Southwest Natural Gas Co.* v. *Commissioner*, 5 Cir., 1951, 189 F. 2d 332, 334. See also *Palm Springs Holding Corporation* v. *Commissioner*, 315 U.S. 185, 62 S. Ct. 544, 86 L. Sd., 785; *Bondholders Committee, Marlborough Investment Co.* v. *Commissioner*, 315 U.S. 189, 62 S. Ct. 537, 86 L. Ed. 784; *Helvering* v. *Southwest Consolidated Corp.*, 315 U.S. 194, 62 S. Ct. 546, 86 L. Ed. 789."

> the cases mean simply that facts must be presented from which it can reasonably be concluded that the new corporation is in substance the old corporate enterprise in a new form. Thus, it is seen that a creditor's plan must not only satisfy the literal language of the statute, but must also meet the 'continuity of interest' test."

By way of conclusion, then we review the case as presented to the Tax Court and the Court of Appeals upon the Petition, the Answer and the Stipulation of Facts, together with the exhibits attached thereto. They indicate that several individuals operated a furniture store in Indianapolis as partners, and in May 1, 1923, transferred the partnership assets to a corporation under the name of Goldstein Bros., Inc. Fourteen Hundred (1,400) shares of stock were issued by the corporation in exchange for assets of the partnership, amounting to Four Hundred Thirty-Four, Six Hundred Twelve and 49/100 (434,612.49) Dollars. The stockholders of the corporation were the same as the members of the partnership and the stock was divided among them in the same proportion as their partnership investment.

The closing balance sheet of the partnership was used as the opening balance sheet of the corporation, except that Two Hundred Eighty Thousand ($280,000.00) Dollars was set up for good will, thus the outstanding issued corporate capital stock was increased to Seven Hundred Fourteen Thousand, Six Hundred Twelve and 49/100 (714,612.49) Dollars. This business was carried on to April 14, 1932, when additional three hundred and thirty-five (335) shares of preferred stock, with par value of One Hundred ($100.00) Dollars was issued and on January 31, 1934, the corporation filed Petition in bankruptcy.

Exhibit 7-G attached to the Stipulation indicates that the Bankruptcy Court ordered the sale of the assets to the Washington and Delaware Mercantile Company, Inc. (being the

Petitioner herein that shortly thereafter assumed its corporate name of Goldstein Bros., Inc.). Stipulation paragraph 8 indicates that the bankrupt corporation had claims of general creditors amounting to Eighty-Four Thousand, Four Hundred Seventy-Four and 88/100 ($84,474.88) Dollars, and that the receipts from the sale amounting to Sixty Thousand, One Hundred Twelve and 62/100 ($60,112.62) Dollars were disbursed to creditors after payment of court expenses. The old corporation had three hundred thirty-five (335) shares of preferred stock of a par value of One Hundred ($100.00) Dollars. Stipulation 9 indicates that the new corporation also issued three hundred thirty-five (335) shares of preferred stock and five hundred (500) shares of common stock, no par value. Both the common and preferred stock went to the same stockholders so that the stockholders of the old corporation and the stockholders of the new corporation were exactly the same and in the same proportion.

Exhibits 1-A to 6-F are the tax returns filed by the corporation, and the first one for the year 1943 indicates that money paid in for stock or paid in surplus or contribution to capital, is Four Hundred Sixty-Eight Thousand, One Hundred Twelve and 49/100 ($468,112.49) Dollars. This, you will notice, is made up of the Four Hundred Thirty- Four Thousand, Six Hundred Twelve and 49/100 ($434,612.49) Dollars (stipulation paragraph 4) plus the Thirty-Three Thousand, Five Hundred ($33,500.00) Dollars paid for the Three Hundred Thirty-Five (335) shares of preferred stock and Five Hundred (500) shares of common stock. The tax returns attached as exhibits for the years 1944 and 1945 have schedules included which clearly explain the invested capital of the corporation as being made up of the investments in the old corporation plus the additions in the new corporation. When we consider the numerous decisions by the Tax Court, Circuit Court of Appeals and the Supreme Court in applying the provisions of the Rev-

enue Act applicable to the years in question, we fail to see upon what basis the Commissioner expects this Court to disregard them. Clearly, this is a case where the same group of stockholders started the business as a partnership prior to 1923, carried it on as a corporation until the year 1934 when through a bankruptcy proceeding, it adjusted its obligations with its creditors and continued the present taxpayer corporation as carrying on the same business.

This is a clear case where the same stockholders maintained a "continuity of interest" in the successor corporation as it existed in the predecessor corporation and partnership. The investment made at the beginning in the partnership and carried over to the corporation in 1923, was still beneficial to the corporation resulting after the bankruptcy. The investment was properly considered in order to establish its excess profits tax credit. The very same stockholders of the bankrupt corporation were the stockholders of the new corporation. The very same assets of the bankrupt corporation were the assets of the new corporation. The creditors' claims of the bankrupt corporation were settled by the funds provided by the stockholders of the bankrupt corporation, who were also the stockholders of the new corporation. Under the decisions pointed out above, we respectfully submit their being no dispute of facts involved herein, the conclusions of law reached by the lower Court were in error and should be reversed, this Court should hold that the deficiency proposed is improper and its decision should be for the taxpayer.

CONCLUSION

Wherefore Petitioner respectfully submits that upon the grounds stated herein, that this petition for a writ of certiorari should be granted by this Court and the action of the lower Court reviewed and finally reversed, and the decision entered in favor of the Petitioner herein.

Respectfully submitted,

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July 10, 1956.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit

No. 11520

Wednesday, April 11, 1956

Before
Hon. H. Nathan Swaim, Circuit Judge
Hon. Elmer J. Schnackenberg, Circuit Judge
Hon. Casper Platt, District Judge

GOLDSTEIN BROTHERS, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Review of a Decision of the Tax Court of the United States.

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on March 23, 1955 be, and the same is hereby, AFFIRMED.

(As corrected pursuant to Order entered May 18, 1956)